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IN THE

Supreme Court of the United States

No. 472
October Term, 1964

ROBERT P. McCULLOCH,
Plaintiff and Appellant,
vs.
CALIFORNIA FRANCHISE TAX BOARD,
Defendant and Appellee.

Petition for Rehearing of Order Granting Motion to Dismiss Appeal Under Rule 58(1).

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Petition for Rehearing of Order Granting Motion to Dismiss Appeal Under Rule 58(1).

Appellant Robert P. McCulloch respectfully requests that this Court grant rehearing of its order dated November 23, 1964, which dismissed the appeal for lack of a substantial federal question, and further requests that on rehearing the Court now note probable jurisdiction and entertain this appeal. This petition is filed under Rule 58(1) of the Rules of this Court.

The appellee Franchise Tax Board's Motion to Dismiss or Affirm stated the question presented herein was whether the beneficiary's residence was sufficient nexus to tax income to the trust:

> "Does the appellant's residency in California in his capacity as the contingent beneficiary and as one of three trustees, provide sufficient nexus to income accumulated by an out-of-state trust so as to allow California to [tax that income to the trust]?"

The Franchise Tax Board contended "that there was sufficient nexus by reason of the appellant's residency" (Motion to Dismiss or Affirm, p. 4). That this was the essential question seems clear from statements in the opinions below.[1]

The Appellant's Jurisdictional Statement did argue the importance of this question and of other collateral questions of constitutional law raised by that decision. Appellant did not, however, indicate that there existed any conflict of decisions between the California decision and the decisions of other states, or that other cases were awaiting decision in this matter pending the outcome of this case.

Appellant suggests to this Court authorities indicating two additional reasons why the federal questions here involved are indeed substantial:

1. The decision in *McCulloch* conflicts with recent decisions in other jurisdictions.
2. The questions involved are more important than the number of appellate decisions indicates because appellate litigation is improbable. But substantial inferior court litigation *is* probable.

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[1] "* * *the beneficiary's state of residence may properly tax the *trust* on income which is payable in the future to the beneficiary, although it is actually retained by the trust * * *." (Jurisdictional Statement App. A, p. 11 (Calif. Sup. Ct. Opinion));

"* * *taxation * * * could not be predicated solely on the residence of the plaintiff in California * * *. See *Miller Bros. Co. v. Maryland*, 341 U. S. 340, 344-345 * * *." (*Idem*, App. A, pp. 23-24, Opinion, Calif. Dist. Ct. Appls.];

"* * * we face squarely the constitutional question of whether income accumulated by this trust may be taxed by California upon the ground that the beneficiary is a California resident. * * *" (*Idem* at App. A, p. 27, dissent.)

I.

The Decision in McCulloch Conflicts With Recent Decisions in Other Jurisdictions.

The California Supreme Court held that income received and accumulated in the years 1936-1950 was taxable *to the trust* as of those years because of the residence of the *beneficiary*, even though the beneficiary did not actually receive the sums until principal (including these accumulations was distributed to him when he survived to age 40 in 1951. The Court so held despite the fact that all of the administrative business of the trust was, by express terms, transacted in another state.

Other cases involving the taxation of accumulations to foreign trusts have reached conflicting results.

> Compare *Pabst v. Dept. of Taxation*, 19 Wis. 2d 313, 120 N. W. 2d 77 (1963),
>
> with *Mercantile-Safe Deposit and Trust Company v. Murphy*, 19 App. Div. 2d 765, 242 N. Y. Supp. 2d 26 (1963).

In *Pabst*, the Wisconsin Supreme Court held constitutional (against attack under the Fourteenth Amendment) Wisconsin's taxation of capital gains accumulated into principal by non-resident trustees for a non-resident beneficiary.

The *Mercantile-Safe Deposit* case held *unconstitutional* New York's attempt to levy income tax upon accumulations made by a non-resident trustee of an *inter vivos* trust created by a New York resident for a non-resident beneficiary.

Mercantile-Safe Deposit cited in support *Safe Deposit and Trust Co. v. Virginia*, 280 U. S. 83 (1929). It appears to be in direct conflict with the opinion of the California Supreme Court in *McCulloch*.

Pabst, holding its statute constitutional, cited in support thereof *Wisconsin v. J. C. Penney Co.*, 311 U. S. 435, 445 (1940). While agreeing with *McCulloch* on the issue of constitutionality, the *Wisconsin* case takes an inconsistent position with *McCulloch* in that in Wisconsin actual management in the state is held to provide *nexus;* in California, actual management elsewhere does not destroy *nexus*.

Counsel for appellant have been contacted by at least six other firms representing taxpayers whose deficiencies are being held in abeyance pending the outcome of this litigation and is informed by them that the Franchise Tax Board is holding in abeyance numerous other cases pending the outcome of this suit. Counsel is aware of two other decisions which ended in the California Superior Courts—both contrary to the *McCulloch* ruling. In one (*Long v. Franchise Tax Board*, Sacramento County Super. Ct. No. 118208), the State took no appeal, and in the other (*Dollar Savings & Trust Co. v. Franchise Tax Board*, Sacramento County Super. Ct. No. 120471), an appeal by the State was settled in preference to litigation.

All these patterns indicate that litigation does arise on the taxation of accumulations in multi-state trusts, but that has the litigation does not travel far through the courts.[2]

We suggest these cases show that the question here is not a question peculiar to California alone, or novel only

[2]The subject was of sufficient importance to become the topic of a paper soon to be published—Ferrell, *State Taxation of Income Accumulated in Trusts*—at the Annual Conference of the National Association of Tax Administrators in New Orleans in June, 1964.

because of the special facts of this case, but that the issues posed by the *McCulloch* decision arise wherever income tax statutes are applied to multi-state trusts, all over the country, and that the cases are in conflict.

II.

The Questions Involved Arise With Greater Frequency Than Appellate Decisions Indicate Because Appellate Litigation Is Improbable.

There are individual income tax statutes in 34 states.[3] Many of these, like California, seek to tax income accumulated and later distributed, such as is involved here, some using language strikingly similar to the California statute.[4] Many likewise seek to tax income of non-residents as well as that of residents.[5] Two states—Michigan and Ohio, respectively the seventh and fifth most populous states in the nation—have enacted a uniform municipal income tax ordinance which permits municipalities to levy an income tax. Under these laws over 60 Ohio municipalities have enacted income tax laws—all with a limitation on rates of one percent—and the population centers of Detroit and Hamtramck have enacted municipal ordinances.[6]

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[3]Penniman and Walter Heller, *State Income Tax Administration* (ed. 1959) 7-8 (30 states) plus the following four added since 1959: Alaska (Alaska Stats. Sec. 43.20.010); Hawaii (Haw. Rev. Laws (1963 Supp.) Secs. 121-3, 121-13); Tennessee (12 Tenn. Code Ann. (Bobbs-Merrill 1955) Sec. 67-2616 and -2617); and West Virginia (W. Va. Code Ann. (Michie 1961) Sec. 999 (50aaa) and (50bbbb)).

[4]See, *e.g.*, Mo. Stats. Ann. (Vernon 1952) Sec. 143.130.

[5]See, *e.g.*, West. Va. Code Ann. (Michie 1961) Sec. 999 (50 aaaa) and (50bbbb) (taxation of non-resident estates or trusts); Haw. Rev. Laws (1963 Supp.) Secs. 121-3; 121-13 (taxation of "every" estate or trust);

[6]See *United States Advisory Commission On Inter-Governmental Relations, State Constitutional and Statutory Restrictions On Local Taxing Procedures* (1962) 88.

All of these statutes have one common denominator: The upper limit of taxation is low—ranging from 10% down to 1%. Consequently, the deficiencies assessed are small when the state seeks to apply the statutes to foreign trusts, and the amounts involved seldom support constitutional litigation involving substantial expenditure of time, effort and money.

In such circumstances it is improbable that litigation will occur in such form as to be recorded in appellate decisions, even though the decisions may be in conflict.

> *Cf. Schriber-Schroth v. Cleveland Trust Co.*, 305 U. S. 47, 50 (1938) where certiorari was granted on rehearing after earlier denial of a petition for certiorari by this Court, when the petition for rehearing disclosed that litigation in different circuits was improbable;
>
> See *Paramount Publix Corp. v. American Tri-Ergon Corp.*, 293 U. S. 528 (1934).

In the present circumstance we suggest that appellate litigation is improbable — and visible conflict therefore doubtful — because of the small size of individual cases. But the collective amounts of money will be large—and the rights of taxpayers will be just as much infringed. We do not think that this Court will fail to recognize the substantiality of a federal question, if otherwise substantial, merely because the amounts involved in each case are small, or that appellate litigation is unlikely.

Indeed, this fact seems more an inducement to recognize the substantiality of the question than a deterrent. It indicates that many cases involving similar questions are arising that are not being litigated to the appellate

court. If this Court does not now accept jurisdiction in the current case, it is unlikely that it will have the opportunity soon again to litigate a question which — every one agrees — has never yet been decided (see Jurisdictional Statement, page 14) and which is even now being decided inconsistently.

The small number of reported cases belies the frequency with which the issue arises; but such decisions as exist make it clear that further guidance of this Court is needed.

Conclusion.

It has been suggested that this Court sometimes shows its approval of a decision on the merits by such an order as it handed down on November 23, 1964, in this case. See Stern and Gressman, *Supreme Court Practice* (3d ed. 1962), pp. 195-196. Obviously, counsel for the taxpayer consider the case to have been wrongly decided. But whether right or wrong, we believe the case is of sufficient importance — and the varying interpretations of the constitutional law on the subject sufficiently in conflict—to merit full consideration by this Court. We believe this is especially true where it is unlikely that the Court will soon have the opportunity again to decide the question.

Respectfully submitted.

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